



# JOINT ECONOMIC COMMITTEE

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## ECONOMIC VITAL SIGNS: DECEMBER 2005

The economy grew at a brisk pace in the third quarter of 2005. While employment growth did sag immediately following the hurricanes, employment growth rebounded in November. Concerns that there would be a significant drop in national employment and economic growth due to the hurricanes proved to be unfounded.

### Economic Indicators

- Economy grew at 4.3% in the 3<sup>rd</sup> Quarter
- Employment
  - 215,000 payroll jobs were added in Nov.
  - 5.0% unemployment rate in Nov.
  - 4.5 million payroll jobs added since May 03
- Fixed investment rose 8.6% in 3<sup>rd</sup> Quarter
- Industrial production rose 0.7% from October to November
- Real disposable personal income increased 0.2% from September to October
- New home sales rose 13.0% Sept. to October
- Inflation, from Oct. 04 to Oct. 05
  - 3.4% increase in prices for PCE
  - 1.6% increase excluding energy & food
- Interest rates as of December 9
  - Home mortgage rates averaged 6.29%
  - The prime rate stood at 7.25%

### REAL GDP

Third quarter **gross domestic product (GDP), the measure of current output of goods and services produced by labor and property located** in the U.S., increased at an annual rate of 4.3%. This estimate of GDP is an upward revision of the estimate that the Bureau of Economic Analysis reported in October. The recent growth of GDP – significantly above the 30-year average growth of 3.1% – shows that the hurricanes did not significantly reduce the momentum of the national economy.

### EMPLOYMENT

Since the beginning of the year, the economy has created 1.8 million non-farm payroll jobs. At the end of November, the rate of unemployment stood at 5.0%. The hurricanes did create significant employment dislocations in the affected regions and, as a result, national payroll gains in September and October were well below the employment growth trend. The most recently reported employment statistics, however, show that the rate of job growth before the hurricanes has returned.

### INDUSTRIAL PRODUCTION

Industrial production increased 0.7% in November, following an upward-revised gain of 1.3% in October. November's output was 2.8% above last year. These gains reflect the recovery of energy-related industries affected by the hurricanes.

The Institute for Supply Management (ISM) reports that manufacturing activity is still expanding. Economic activity in the manufacturing sector grew in November for the 30<sup>th</sup> consecutive month, albeit at a slightly slower pace than in October. According to the ISM, the overall economy has grown for the 49<sup>th</sup> consecutive month.

Statistics for new orders for durable goods can be highly volatile. New orders for durable goods decreased 2.0% from August to September but increased 3.7% from September to October. New orders for all manufacturing industries increased 2.2% in October after dipping 1.4% in September. In four of the last six months, manufacturers' new orders have increased.

## **PERSONAL INCOME AND CONSUMPTION**

In October, real disposable personal income increased 0.2%. Due to the effects of the hurricanes, the sources of personal earnings that comprise real disposable income have fluctuated to a great extent. For example, the growth in employee compensation and other personal income was overwhelmed by the loss in property-related income caused by hurricane damage.

Real personal consumption expenditures (PCE) increased 0.1% in October after falling 0.4% in September. Purchases of durable goods in general, and motor vehicles more specifically, decreased in both months and account for the weak PCE showing.

## **HOUSING SECTOR**

The outlook for the housing sector appears to be mixed. Sales of new single-family houses increased 13.0% from September to October but, over the same period, existing home sales declined. Building permits and housing starts were both lower in October compared to either September 2005 or October 2004.

## **INFLATION**

Core inflation, or the change in the level of prices that excludes volatile energy and food prices, remains low. For October, the core market-based personal consumption expenditures (PCE) price index increased by 1.6% from October of 2004. The change in the market-based PCE index – the index that includes food and energy – increased by 3.4% from October one year ago. The core Consumer Price Index was 2.1% higher in November compared to last year.

## **INTEREST RATES**

In an effort to restrain inflationary pressures, the Federal Reserve raised the federal funds rate to 4.25% on December 13. The prime rate moves in lockstep with the federal funds rate. It rose to 7.25%, having stood at 7.0% in November.

Treasury interest rates and mortgage rates continued their measured increase. Rates on 10-year Treasury notes have moved from an October average of 4.46% to 4.55% in November. Since the beginning of 2004, the interest rate of 10-year Treasury securities has fluctuated between 3.75% and 4.81%. The standard 30-year mortgage rate that averaged 6.07% in October rose to an average of 6.33% in November.

## **ENERGY COSTS**

Crude oil and gasoline prices have returned to their pre-Katrina level. While gasoline prices have moderated and helped to restore consumer confidence, significantly higher heating oil and natural gas prices will confront consumers in the coming months. The Energy Information Administration has forecasted that heating costs for homes heated with fuel oil will be 21% higher than last year. Households heated by natural gas can expect heating costs that are 38% more than last year. If consumers respond to higher energy costs by significantly reducing the purchases of other goods and services, it may have a dampening effect on economic growth.

## **RETAIL SALES**

November retail and food services sales increased 0.3% from the previous month and 6.3% from last year. November sales of building material and garden equipment dealers were strong, up 14.5% from last year. After a three month slide, motor vehicle sales increased 2.6% in November, but are still 2.0% lower than last year.

## **CLOSING THOUGHTS**

Despite higher energy costs and the loss of production due to the hurricanes, the economy still registered robust economic growth. Higher energy costs and a return to historical rates of home value appreciation may temper consumer spending, but most indicators still point to healthy economic performance in late 2005 and 2006.